and requiring auditing firms to publicly disclose these indicators. Testimonies and comment letters have suggested specific audit quality indicators, such as the average experience level of auditing firm staff on individual engagements, the average ratio of auditing firm professional staff to auditing firm partners on individual engagements, and annual staff retention. The Committee also recommends that, if the proposal is feasible, the PCAOB, through its inspection process, should monitor these indicators.

Recommendation 4. Promote the understanding of and compliance with auditor independence requirements among auditors, investors, public companies, audit committees, and boards of directors, in order to enhance investor confidence in the quality of audit processes and audits.

The Committee considered testimony and comment letters regarding the significance of the independence of the public company auditor—both in fact and appearance—to the credibility of financial reporting, investor protection, and the capital formation process.[163] The auditor is expected to offer critical and objective judgment on the financial matters under consideration, and actual and perceived absence of conflicts is critical to that expectation.

The Committee believes that auditors, investors, public companies, and other market participants must understand the independence requirements and their objectives, and that auditors must adopt a mindset of skepticism when facing situations that may compromise their independence. In that regard, the Committee makes the following recommendations:

(a) Compile the SEC and PCAOB independence requirements into a single document and make this document Web site accessible. The American Institute of Certified Public Accountants (AICPA) and states should clarify and prominently note that differences exist between the SEC and PCAOB standards (applicable to public companies) and the AICPA and state standards (applicable in all circumstances, but subject to SEC and PCAOB standards, in the case of public companies) and indicate, at each place in their standards where differences exist, that stricter SEC and PCAOB independence requirements applicable to public company auditors may supersede or supplement the stated requirements. This compilation should not require rulemaking by either the SEC or the PCAOB because it only calls for assembly and compilation of existing rules.

In the United States, various oversight bodies have authority to promulgate independence requirements, including the SEC and PCAOB for public company auditors, and the AICPA and states for public and private company auditors.[164] The Committee recommends that the SEC and PCAOB compile and publish their independence requirements in a single document and make this document easily accessible on their Web sites. The Committee recommends that the AICPA and states clarify and prominently state that differences exist between their standards and those of the SEC and the PCAOB and indicate, at each place in their standards where differences exist, that additional SEC and PCAOB independence requirements applicable to public company auditors may supersede or supplement the stated requirements.[165]

(b) Develop training materials to help foster and maintain the application of healthy professional skepticism with respect to issues of independence and other conflicts among public company auditors, and inspect auditing firms, through the PCAOB inspection process, for independence training of partners and mid-career professionals.

The Committee considered testimony and commentary that, to comply with the detailed and complex[166] requirements, some auditors may be taking a ''check the box'' approach to compliance with independence requirements, and losing focus on the critical need to exercise independent judgment or professional skepticism about whether the substance of a potential conflict of interest may compromise integrity or objectivity, or create an appearance of doing so.[167]

The Committee recommends that auditing firms develop appropriate independence training materials for auditing firms, especially partners and mid-career professionals, that help to foster a healthy professional skepticism with respect to issues of independence that is objectively focused and extends beyond a ''check the box'' mentality. The training materials should focus on lessons learned and best practices observed by the PCAOB in its inspection process and the experience of other relevant regulators as appropriate. To ensure the implementation of this training on an overall basis, the PCAOB should review this training as part of its inspection program.

Recommendation 5. Adopt annual shareholder ratification of public company auditors by all public companies.

Although not statutorily required, the majority of public companies in the United States—nearly 95% of S&P 500 and 70%–80% of smaller companies—put auditor ratification to an annual shareholder vote.[168] Even though ratification of a company's auditor is non-binding, the Committee learned that corporate governance experts consider this a best practice serving as a ''check'' on the audit committee.[169] Pursuant to Sarbanes-Oxley, audit committees of exchange-listed companies must appoint, compensate, and oversee the auditor.[170] SEC rules implementing Sarbanes-Oxley specifically permit shareholder ratification of auditor selection.[171] Ratification allows shareholders to voice a view on the audit committee's work, including the reasonableness of audit fees and apparent conflicts of interest.

The Committee believes shareholder ratification of auditor selection through the annual meeting and proxy process can enhance the audit committee's oversight to ensure that the auditor is suitable for the

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[163] See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of Dennis M. Nally, Chairman and Senior Partner, PricewaterhouseCoopers LLP, 5) *available at, http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Nally120307.pdf* (''Independence forms the bedrock of credibility in the auditing profession, and is essential to the firms' primary function in the capital markets.''); Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 3), *available at http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Nusbaum020408.pdf.*

[164] See, e.g., SEC Regulation S–X, Article 2, Rule 2–01—Qualifications of Accountants, 17 CFR § 210.2–01; SEC Financial Reporting Policies, Sec. 602.01—Interpretations Relating to Independence; SEC Final Rule, Amendments to SEC Auditor Independence Requirements ''Strengthening the Commission's Requirements Regarding Auditor Independence'', SEC Rel. No 33–8183 (2003); SEC Final Rule, Revision of the Commission's Auditor Independence Requirements, SEC Rel. No. 33–7919 (2001); PCAOB, Interim Independence Standards, ET Sections 101 and 191; Independence Standards Board, Independence Standards Nos. 1, 2, and 3, and ISB Interpretations 99–01, 00–1, and 00–2; PCAOB Bylaws and Rules, Section 3, Professional Standards; AICPA Code of Professional Conduct, ET Sections 100–102.

[165] The Committee took note of concerns expressed regarding independence issues from a variety of perspectives. See, e.g., Andrew D. Bailey, Jr., Professor of Accountancy—Emeritus, University of Illinois, and Senior Policy Advisor, Grant Thornton LLP, Comment Letter Regarding Discussion Outline 9 (Jan. 30, 2008), *available at http://comments.treas.gov/_files/BAILEYCOMMENTSONTREASURYADVISORY COMMITTEEOUTLINEFINALSUBMISSION 13008.doc* (suggesting simplifying the current SEC independence standards); Dana R. Hermanson, Kennesaw State University, Comment Letter Regarding Discussion Outline 1 (Oct. 4, 2007), *available at http://comments.treas.gov/_files/HermansonStatement10407.pdf* (stating that consulting and auditing were incompatible and posed a significant threat to the long-term sustainability of the profession); Record of Proceedings (Dec. 3, 2007) (Written Submission of Dennis M. Nally, Chairman and Senior Partner, PricewaterhouseCoopers LLP, 5), *availabe at http http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Nally120307.pdf* (''The independence rules should be re-evaluated periodically to examine whether the rules continue to strike the right balance between cost burden and benefit.''); Record of Proceedings (Dec. 3, 2007) (Written Submission of James S. Turley, Chairman and Chief Executive Officer, Ernst & Young LLP, 5), *available at http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Turley 120307.pdf* (recommending consideration of potential changes to aspects of independence rules).

[166] See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of Michael P. Cangemi, President and Chief Executive Officer, Financial Executives International), *available at http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Cangemi120307.pdf;* Financial Executives International, Recommendations to Address Complexity in Financial Reporting (March 2007).

[167] See. e.g., Consideration of Fraud in a Financial Statement, Interim Auditing Standard AU 316, Paragraph .13 (Pub. Company Accounting Oversight Bd. 2002) (''Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence.'').

[168] Institutional Shareholder Services, ISS U.S. Corporate Governance Policy—2007 Update 3 (Nov. 15, 2006).

[169] Institutional Shareholder Services, Request for Comment—Ratification of Auditors on the Ballot 1.

[170] Sarbanes-Oxley Act, 15 U.S.C. § 78j–1 (2002).

[171] SEC, Final Rule: Standards Related to Listed Audit Committees. Release No. 33–8220 (Apr. 9, 2003).